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IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

No. 249

CLINTON S. LUTKINS, SIDNEY W. DAVIDSON and UNITED STATES TRUST COMPANY OF NEW YORK, as executors of the last will and testament of George Arents, deceased, and United States Trust Company of New York, as executor of the last will and testament of Lena R. Arents, deceased,

Petitioners,

—against—

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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—against—

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

To the Honorable Chief Justice and the Associate Justices of the Supreme Court of the United States.

Petitioners pray that a writ of certiorari issue to review the decision of the United States Court of Claims entered in the above-entitled case on February 6, 1963.

Opinions Below

The majority and dissenting opinions of the Court of Claims, printed in Appendix A hereto, *infra*, pp. A 1-20, are reported in 312 F. 2d 803.

Jurisdiction

The grounds on which the jurisdiction of this Court is invoked are:

(i) The date of the judgment sought to be reviewed and the time of its entry was February 6, 1963.

(ii) A timely motion for rehearing was filed on March 7, 1963, and was denied in an order entered April 5, 1963. There has been no order entered granting an extension of time within which to petition for certiorari.

(iii) The statutory provision which the petitioners believe confers jurisdiction on this Court to review the judgment in question by writ of certiorari is Title 28 U.S.C., Section 1255(1); c. 646, 62 Stat. 928.

Question Presented

The following question is presented for review:

Whether a corporation effects a "reorganization" within the meaning of section 112(g)(1)(B) of the Internal Revenue Code of 1939 if it acquires not only 80 percent of the voting stock of another corporation in exchange solely for its voting stock, but also in separate transactions in other years acquires additional voting stock of that corporation by purchases for cash.

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Statutes and Regulations Involved

The statutory provisions involved are sections 112(b)(3) and 112(g)(1)(B) of the Internal Revenue Code of 1939 as in effect in 1952 (Title 26 U.S.C., 1952 ed.). The regulations involved are sections 39.112(a)-1(E) and 39.112(g)-1 and (g)-2 of Regulations 118 as in effect in 1952. These statutory provisions and regulations are printed in Appendix B, *infra*, pp. B 1-5.

Statement of the Case

The facts in this suit were completely stipulated, and, as stipulated, were adopted by the lower Court as its findings of fact. These findings are set out in their entirety in the opinion (pp. A 16-20, *infra*).

In 1912 American Machine & Foundry Company (hereafter referred to as American Machine) acquired in exchange solely for 11,000 shares of its common stock (which was its only stock having voting rights) 65,375 shares of the capital stock of International Cigar Machinery Company (hereafter referred to as International). In the same exchange American Machine also acquired several other items not material to this case. The capital stock of International was its only stock and its sole voting stock. The 65,375 shares represented 65.375 percent of International's total issued shares of capital stock.

Having acquired 65.375 percent of the stock of International, American Machine, in four separate

transactions, purchased for cash shares of International stock as follows:

Year	Number of Shares	Percent of Outstanding Stock
1929	7,750	1.291⅔
1931	1,958	.326
1934	3,042	.507
1951	3,400	.567
Totals	16,150	2.691⅔

Thus, at the beginning of 1952 American Machine owned 68.066⅔ percent of International's stock as the result of separate cash and exchange transactions commencing 40 years earlier.

During 1952 American Machine exchanged 235,918⅔ shares of its voting stock for 176,939 shares of International's stock (representing 29.489 percent of International's total issue).

Taxpayers owned 18,100 shares of International stock which they exchanged in 1952 for 24,133½ shares of American Machine stock. In their joint Federal income tax return for the calendar year 1952 they reported a capital gain of $283,931.32 resulting from the aforesaid exchange. The amount in issue in this suit is $48,268.34 representing the capital gains tax paid on the aforesaid capital gain. A claim for the refund of this tax was duly filed with the District Director of Internal Revenue, Upper Manhattan District, New York, and was in due course disallowed in full. Suit was filed with the United States Court of Claims for the recovery of the aforesaid capital gains taxes and on February 6, 1963, that Court entered its decision dismissing the petition. This

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decision represented the view of the majority of four of the five judges but one of the judges did not agree with the decision of the majority. He also was of the opinion that the petitioners' motion for a rehearing should be granted.

Jurisdiction of the Court of First Instance

The United States Court of Claims was the Court of first instance. That Court had jurisdiction to review the disallowance, by the Commissioner of Internal Revenue, of the claim for refund under Title 28 U.S.C., Section 1346(a)(1).

Reasons for Granting the Writ

The special and important reasons for granting a writ of certiorari are:

(1) The Court of Claims has rendered a decision in conflict with a decision of the Court of Appeals for the Seventh Circuit on the same matter.

(2) The Court of Claims has decided an important question of federal law which has not been, but should be, settled by this Court.

(3) The Court of Claims has decided a federal question in a way in conflict with applicable decisions of this Court.

ARGUMENT

POINT I

The Court of Claims has rendered a decision in conflict with a decision of the Court of Appeals for the Seventh Circuit on the same matter.

In this case the Court of Claims found as a fact that 94.864 percent of the voting stock of International had been acquired in exchange solely for voting stock of American Machine (Paragraph 14 of Findings of Fact, p. A 19, *infra*). Nevertheless, the Court held that this acquisition did not meet the required amount of stock, which the statute prescribed as "at least 80 per centum of the voting stock" because other stock of International, viz. 2.691⅔ percent, had been acquired by cash purchases, although in different years from those of the acquisition in exchange for voting stock. In *Howard* v. *Commissioner*, 238 F. 2d 943 (1956) the Court of Appeals for the Seventh Circuit held that no taxable gain was realized by stockholders who had exchanged 80.19 percent of the stock of a corporation solely for voting stock of the acquiring corporation although the holders of the balance of the stock received cash for their shares in the same transaction.

In *Turnbow* v. *Commissioner*, 368 U.S. 337 (1961) certiorari was granted to resolve the conflict between the decision in that case by the Court of Appeals for the Ninth Circuit and the decision of the Seventh Circuit in the *Howard* case, *supra*. However, al-

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though this Court affirmed the *Turnbow* decision it did not criticize the *Howard* decision. This would indicate that this Court may have believed the facts in that case satisfied the requirements of the statutory definition of reorganization. It laid down the rule that the "boot" provisions did "not apply unless some part, at least, of the property exchanged *actually* meets the particular description contained in the applicable section or subsection of the Code." After holding that an exchange of stock *and* cash—approximately 30 percent in stock and 70 percent in cash—cannot be a reorganization as defined in section 112(g)(1)(B), it stated: "That holding determines this case and is all we decide." p. 344.

Thus the *Howard* decision stands unaffected and is in direct conflict with the decision in the Court of Claims below. See Horrow, *Recent Developments in Corporate Reorganization*, 1963 So. Calif. Tax Inst. 252-6.

POINT II

The Court of Claims has decided an important question of federal law which has not been, but should be, settled by this Court.

This is a case of first impression. In general the cases which have been decided in this area have been cases in which the requisite amount of voting stock of the corporation acquired was not acquired in exchange solely for voting stock of the acquiring corporation, but have involved additional consideration such as cash, warrants or other "boot." This is the only adjudicated case involving exchanges solely for vot-

ing stock of the acquiring corporation. These exchanges involved the acquisition of a percentage in excess of the 80 percent required by the statute. Nevertheless, the Court of Claims, relying on *Helvering* v. *Southwest Consolidated Corporation,* 315 U.S. 194 (1942), in which consideration (warrants) in addition to the voting stock was given in the only exchange involved, held that the unequivocal language of this Court in that case required a holding that "the 1929 to 1951 cash transactions prevent the 1952 exchange from being a tax free reorganization."

The Government has thus persuaded the Court of Claims that the cash purchases in the open market were "exchanges" and as such to be considered in determining whether the statutory definition of a "B" reorganization in section 112(g)(1)(B), *infra,* had been met. The Government did not reveal to the Court of Claims that the Treasury Department's own definition of "an exchange" distinguishes it from "a transfer of property for a money consideration only." Regulations 118, section 39.112(a)-1(E), *infra.* It went further, in the face of this regulation, and stated, in its Reply to Plaintiffs' Motion for Rehearing, that four of the exchanges "were for cash." (Transcript, p. 58)

Southwest Consolidated Corporation, supra, is controlling only where cash or consideration other than voting stock is given at the same time and as a part of the "exchange" for voting stock. It is not authority for combining cash purchases in other years with exchanges made solely for voting stock. The issue in this case has never been decided by this Court.

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As Horrow, *supra,* states: "The 'solely' requirement in the definition of 'B' type reorganizations has been in the law since 1934, and yet, almost thirty years later, it is still uncertain as to whether this definition requires that all of the stock acquired in a single transaction be solely for voting stock or whether only 80 percent of the stock of a corporation need be acquired for stock."

Although this case arises under the Internal Revenue Code of 1939 and involves exchanges solely for stock, the "continuity of interest" questions which are involved are present as well under the Internal Revenue Code of 1954. The drafters of the present Code attempted to remove some of the doubts that existed about the former Code provisions on stock for stock reorganizations. Subsequent events make clear, however, that many of the original doubts remain and that additional ones have been created. Since there is still general uncertainty as to the meaning of the 1939 Code provisions there is little agreement as to the intent or effect of the changes made by the 1954 Code. Compare: Bittker, *Federal Income Taxation of Corporations and Shareholders,* pp. 363-5; McDonald and Willard, *Tax Free Acquisitions and Distributions,* 14 N.Y.U. Inst. on Fed. Taxation, 898 (1956); Kanter, 16 *Journal of Taxation,* 276 (May, 1962) and 18 *Journal of Taxation* 138 (March, 1963) especially note 11 of the latter article; 3 Rabkin & Johnson, *Federal Income, Gift and Estate Taxation* pp. 3210-18 (1963) and Horrow, *Recent Developments in Corporate Reorganization, supra.*

As appears above, the *Turnbow* case did not involve the question presented here. In that case there had been no "reorganization". However, the Government

in its brief in that case admitted that "It cannot be said with certainty, for that matter, that there could not be 'other property' in a transaction qualifying as a 'B' or 'C' reorganization," and that "While the Seventh Circuit [in the *Howard* case] held that the cash given the minority precluded a 'B' reorganization, the question is a debatable one and there is no assurance that other courts would follow that decision."

In the complex field of corporate reorganizations, reasonable assurance should exist that adverse tax consequences will not result from legitimate corporate combinations. The *Howard* case and *Richard M. Mills,* 39 T.C. No. 36 illustrate the price of uncertainty, and within past weeks still further evidence of the lack of assurance has appeared. An article in 19 *Journal of Taxation* 60 (July, 1963) describes a corporation listed on the New York Stock Exchange which felt compelled to state in its prospectus relating to the acquisition of stock of another corporation that although the proposed exchange solely of stock for stock appeared to satisfy the statutory requirements, the fact that stock had previously been acquired for cash raised the question "as to whether the present exchange will be a non-taxable transaction, since not all of the stock which will be owned by Maremont will have been acquired in exchange for its stock if the previous acquisitions for cash for purchases in the open market and otherwise are considered a part of this transaction."

Accordingly, this case presents an important question of Federal law which has not been, but should be, settled by this Court.

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POINT III

The Court of Claims has decided a federal question in a way in conflict with applicable decisions of this Court.

The principal decisions of this Court in this area are the *Southwest Consolidated Corporation* case, *supra,* and the *Turnbow* case, *supra.*

The *Southwest Consolidated* case is authority for the principle that in an acquisition of substantially all of the assets of another corporation where the statute requires that the acquisition be made in exchange solely for all or a part of its voting stock, the use of consideration other than voting stock in the exchange does not meet the statutory requirement. This decision has been misapplied by the Court of Claims in the present case where the only exchanges were solely for voting stock.

In the *Turnbow* case, *supra,* this Court held that a "reorganization" required that "some part, at least, of the property exchanged *actually* meets the particular description contained in the applicable section or subsection of the Code." The Court of Claims found as a fact that the property exchanged by American Machine in the acquisition of not less than 94.864 percent of the voting stock of International was its own voting stock, thus actually meeting the particular description in the Code. In failing to hold that a reorganization had resulted, the Court of Claims has decided the question in conflict with the *Turnbow* decision.

Conclusion

For the foregoing reasons, your petitioners pray that a writ of certiorari issue out of this Court to the United States Court of Claims and that the duly certified copy of the transcript of the proceedings below and the printed Appendix which accompany this petition shall be treated as though filed in response to the aforesaid writ to the end that this case may be reviewed and determined by this Court; that the judgment and decision of the Court of Claims be reversed; and that your petitioners be granted such other and further relief as may be proper.

Dated, June 28, 1963.

Respectfully submitted,

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APPENDIX A

Opinions, Findings of Fact and Conclusions of Law of Court Below

IN THE UNITED STATES COURT OF CLAIMS

No. 279–60

(Decided February 6, 1963)

CLINTON S. LUTKINS, SIDNEY W. DAVIDSON AND UNITED STATES TRUST COMPANY OF NEW YORK, AS EXECUTORS, ETC. v. THE UNITED STATES

Ben R. Clark for plaintiffs. *Sidney W. Davidson,* and *Davidson, Dawson & Clark* on the briefs.

Cynthia G. Holcomb, with whom was *Assistant Attorney General Louis F. Oberdorfer,* for defendant. *Edward S. Smith* and *Philip R. Miller* on the brief.

OPINION

LARAMORE, *Judge,* delivered the opinion of the court:

Plaintiffs sue for recovery of income taxes paid on reported capital gains resulting from exchange of stock in one corporation for voting stock in another. The question to be determined in this case is whether the transaction, as later outlined, was a non-taxable exchange under section 112(b)(3) of the Internal Revenue Code of 1939, 26 U.S.C. § 112(b)(3) (1952).

In 1912 the American Machine & Foundry Company (hereinafter called American), a New Jersey corporation, acquired in exchange solely for 11,000 shares of its com-

mon stock (which was its only stock having voting rights) 65,375 shares of the capital stock of International Cigar Machinery Company (hereinafter called International). In the same exchange, American also acquired several other items not material to this case. The capital stock of International was its only stock and its sole voting stock. The 65,375 shares represented 65.375 percent of International's 100,000 total issued shares of capital stock. In 1952, American offered the shareholders of International an exchange of one and one-third shares of its common stock for each share of the capital stock of International. Consummating the acceptance of this offer, American issued 235,918⅔ shares of its common stock to the shareholders of International in exchange for 176,939 shares of capital stock of that company. Due to the fact that the capital stock of International had been split three-for-one in 1927, and two-for-one in 1930, these 176,939 shares amounted to 29.489 percent of its total issued outstanding stock. Therefore, in 1952 American owned 94.864 percent of the voting stock of International which it had obtained solely in exchange for shares of its own voting stock. On 10 separate occasions between 1929 and 1951 American had purchased on the market an adjusted total of 16,150 shares of International stock which comprised 2.691⅔ percent of that company's outstanding stock.

In 1952, George Arents and Lena Arents were the owners respectively of 18,000 and 100 shares of capital stock of International and upon acceptance of American's offer they received in exchange for these shares, 24,000 and 133⅓ shares respectively of the common stock of American. In their joint income tax return for the year 1952, George Arents reported a capital gain of $283,164.65 and Lena Arents reported a capital gain of $766.67 resulting from the aforesaid exchanges. Lena Arents died in 1954 and George Arents died in 1960. The executors of their estates are pursuing a claim for refund filed in 1954,

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contending that the taxpayers erroneously paid $48,268.34 in taxes on the capital gains reported as resulting from the stock exchanges made in 1952. They contend that the 1952 exchange of stock was an exchange on reorganization within the provisions of section 112(b)(3) of the Internal Revenue Code of 1939, *supra,* resulting in no recognized gain or loss.

Section 112(b)(3) of the 1939 Code, *supra,* provides:

* * * *

> No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

Section 112(g)(1)(B), 26 U.S.C. (I.R.C. 1939), § 112(g)(1)(B) (1952), defining reorganization as used in section 112(b)(3), provides:

> (1) The term "reorganization" means * * * (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, * * *.

In essence the plaintiffs contend that the 1952 exchange of stock increased American's holdings of International's stock over the 80 percent requirement of section 112(g)(1)(B) solely by exchanging its own voting stock for that of International, and therefore this 1952 exchange was a tax free reorganization under section 112(b)(3). The Government contends it was not a tax free reorganization for two reasons: (1) American did not acquire 80 percent of International's stock in one single transaction; (2) American did not acquire International stock solely for its own stock but also for cash.

However, for reasons which will become apparent, we will at the outset discuss the second contention urged by the defendant; *i.e.*, did the acquisition of stock for cash between 1929 and 1951 prevent the 1952 stock for stock exchange from being a reorganization under the terms of section 112(g)(1)(B).

The Seventh Circuit in the case of *Howard* v. *Commissioner*, 238 F. 2d 943, wherein the acquiring corporation obtained 80.19 percent of the stock of the acquired company in exchange for its own stock and in the same transaction purchased the remaining 19.81 percent of stock for cash, held that due to the cash payment the transaction failed to meet the "solely" requirement of section 112(g)(1)(B) of the 1939 Code and, therefore, was not a tax free reorganization under section 112(b)(3). This decision followed a similar holding by the Supreme Court in *Helvering* v. *Southwest Consolidated Corporation*, 315 U.S. 194, construing section 112(g)(1) of the Revenue Act of 1934, 48 Stat. 680, 705. In that case, at page 198 of the opinion, the Court in plain and unequivocal language stated:

> • • • Congress has provided that the assets of the transferor corporation must be acquired in exchange "solely" for "voting stock" of the transferee. "Solely" leaves no leeway. Voting stock plus some other consideration does not meet the statutory requirement.

The facts in the case at bar show that there were cash purchases involved in plaintiffs' stock acquisition prior to the 1952 stock for stock transaction. Consequently, in light of the above two cases, we can only hold that the 1952 exchange in the instant case did not meet the statuttory requirement of section 112(g)(1)(B) and, therefore, was not a reorganization thereunder.

Although plaintiffs contend that the cash transactions were not part of the 1952 exchange and therefore do not prevent the 1952 exchange from being considered an ex-

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change "solely" of stock for stock, it must be borne in mind that the 1952 exchange was not by itself an exchange for 80 percent of the stock of the acquired corporation, and therefore did not meet that requirement of section 112(g)(1)(B). Although we do not find it necessary to consider the question of whether the 1912 exchange of stock "solely" for stock and the 1952 exchange can be combined in order to meet the 80 percent requirement of section 112(g)(1)(B), we do not see how the plaintiffs can take advantage of the unrelated 1912 exchange in order to meet the 80 percent requirement and at the same time disregard the similarly unrelated cash purchases. In our view, the plaintiffs' claim must stand or fall on the actual transactions which occurred and the plaintiffs cannot pick and choose for consideration those transactions which, considered by themselves, would make the 1952 exchange a reorganization.

It must be remembered that the statutory exemptions for tax purposes are a matter of legislative grace, and must be strictly construed. In view of the plain language of section 112(g)(1)(B) and the prior constructions of this language in *Helvering* v. *Southwest Consolidated Corporation, supra,* and *Howard* v. *Commissioner, supra,* we hold that the 1929 to 1951 cash transactions prevent the 1952 exchange from being a tax free reorganization and, therefore, bar plaintiffs from receiving the tax advantages arising out of section 112(b)(3).

As an alternative, however, plaintiffs, relying on *Howard* v. *Commissioner, supra,* contend that even if the 1952 exchange was not a reorganization under section 112(g)(1)(B) and, therefore, not exempt from recognition of gain under section 112(b)(3) because of the prior cash transactions, their part of the 1952 exchange being only of stock for stock is not a recognizable gain for tax purposes according to section 112(c)(1) of the 1939 Code.

Section 112(c)(1) provides:

> (1) If an exchange would be within the provisions

> of subsection (b)(1), (2), (3), or (5), * * * of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph * * * to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

In *Howard* v. *Commissioner, supra,* as noted earlier in this opinion, the court found that there was no tax free reorganization because the 80.19 percent of the stock of the acquired corporation was obtained in exchange for stock and 19.81 percent for cash. The court went on, however, to find that the taxpayers in that case were entitled to non-recognition of their gain resulting from the exchange under section 112(c)(1) because they had only received stock in exchange for their stock in the acquired corporation and did not receive any of the cash involved in the transaction. We think this decision by the Seventh Circuit was erroneous, as the Supreme Court so indicated in *Turnbow, infra.* Section 112(c)(1) only applies if a section 112(b)(3), *supra,* reorganization is not tax free because property other than stock or securities was involved in the exchange. Thus, there must first be a section 112(b)(3) reorganization before section 112(c)(1) can become operative. Section 112(b)(3) reorganizations can be any one of six different types and are defined in section 112(g)(1). Section 112(g)(1) in its entirety provides:

> (1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of an-

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other corporation, or (C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all the properties of another corporation, but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded, or (D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (E) a recapitalization, or (F) a mere change in identity, form, or place of organization, however, effected.

In this case there was no reorganization as defined in section 112(g)(1)(B) (the only kind of reorganization contended for by plaintiffs), and therefore section 112 (b)(3) does not enter into the picture. This being so, section 112(c)(1) is also entirely irrelevant to the case.

This does not mean that section 112(c)(1) can never apply to section 112(b)(3) type transactions when property other than stocks or securities are involved in the transaction. This opinion only determines that it does not apply when the taxpayer who is claiming a section 112(g)(1)(B) or (C) reorganization fails to meet the requirements of either of those sections because the exchange was not solely for stock. For instance, a taxpayer might have a section 112(g)(1)(A) reorganization (a merger) in which both stock and some other property are given in exchange. This transaction would not be a tax free reorganization under section 112(b)(3) because property other than stock or securities was involved. However, in that event, under section 112(c)(1) those taxpayers who received stock in the transaction would not have to report a gain while those taxpayers who received

the other property would have a recognized gain on this other property.

We believe this must have been the view of the Tax Court in *Richard M. Mills*, 39 T.C. No. 36, where the plaintiffs claimed a reorganization under section 368 (a)(1)(B) of the 1954 Internal Revenue Code, which is comparable to section 112(g)(1)(B) of the 1939 Internal Revenue Code. In that case, close to 100 percent of stock and a minimal percent of cash were exchanged for stock in the acquired corporation. The Tax Court held, without mentioning the *Howard* case, *supra*, that there was no tax free reorganization and that section 356(a)(1) of the 1954 Code, which is comparable to section 112(c)(1) of the 1939 Code, did not apply. It based its decision solely upon the decision of the Supreme Court in the recent case of *Turnbow* v. *Commissioner*, 368 U.S. 337.

In *Turnbow*, the Court held that section 112(c)(1) did not apply because the involved exchange was one of 70 percent cash and 30 percent stock, thus not meeting the basic 80 percent stock requirement of section 112(g)(1)(B).

We also believe the *Turnbow* case to be determinative of the alternative issue in this case, inasmuch as here, as in the *Turnbow* case, there was no section 112(g)(1)(B) reorganization.

For the above reasons, plaintiffs' petition must be dismissed.

DAVIS, *Judge*; DURFEE, *Judge*; and JONES, *Chief Judge*, concur.

WHITAKER, *Judge*, dissenting:

I do not think any of the prior cases, neither *Helvering* v. *Southwest Consolidated Corporation*, 315 U.S. 194, nor *Howard* v. *Commissioner*, 238 F. 2d 943, have dealt with the situation with which we are presented in this case.

I think we should hold that where a corporation, owning about 68 percent of the stock of another, all of which, ex-

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cept for 2.69 percent, has been acquired solely in exchange for its own voting stock, adopts a plan of reorganization of the two corporations and in pursuance thereof offers to exchange its voting stock solely for the remainder of the outstanding stock of the other, and the offer is accepted, a reorganization under section 112(g)(1)(B) has been effected, because, counting the stock acquired both before and after adoption of the plan of reorganization, more than 80 percent of the stock of the latter corporation has been acquired solely for the voting stock of the former, and the acquisition for cash of the small percentage of 2.69 percent, being wholly unrelated to the plan of reorganization, is to be disregarded.

Section 112(b)(3), upon which plaintiffs rely, reads:

> No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

Section 112(g)(1)(B), defining a reorganization, reads in part as follows:

> The term "reorganization" means * * * (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, * * *.

In 1912, when American acquired 65.37 percent of the voting stock of International, there seems to have been no thought in mind of a reorganization. American apparently desired control of International, but they do not seem to have had in mind a reorganization of the two companies. Certainly what they did was not sufficient to effect one.

Then in 1929, some 17 years later, American, for some

undisclosed reason, acquired 1.291⅔ percent of International stock, in addition to what it already had. Two years later, it acquired an additional .326 percent of International stock, and three years later .507 percent. Nothing more was done along this line for seven years. Then in 1951 it acquired an additional amount of .567 percent. These transactions gave American a total of slightly over 68 percent of the stock of International.

Up to this time there seems to have been no intention on the part of American to effect a reorganization with International, although American had sought control of International.

Then, in April 1952, American seems to have first conceived the idea of effecting a consolidation with International. Three things seemed to have induced it to arrive at this decision: (1) It wanted to settle a derivative stockholders' suit against International and itself; (2) it wanted to be able to include International in its consolidated financial statements, for the purpose, among other things, of increasing its borrowing power under a certain credit agreement; (3) to enable it to include International in its consolidated Federal income tax return.[1]

Thus the stipulation of facts clearly indicates that this is the first time that any idea of a reorganization was conceived.

So, we are confronted with the application of section

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[1] The eleventh paragraph of the stipulation of facts reads:

"In April 1952 American Machine and Foundry Company made an offer to the stockholders of International Cigar Machinery Company to exchange 1⅓ shares of American Machine & Foundry Company common stock for each share of the capital stock of International Cigar Machinery Company."

The twelfth paragraph states:

"In its Prospectus, dated April 21, 1952, the American Machine & Foundry Company stated that the purposes of this offer were: [those set out above]."

Then in the thirteenth paragraph the stipulation says that "Pursuant to this offer" the American acquired so many shares of International stock.

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112(g)(1)(B) of the 1939 Internal Revenue Code to a situation where one corporation, owning about 68 percent of the stock of another corporation, desires to effect a reorganization with it. It is obviously impossible for such a corporation to comply with the terms of 112(g)(1)(B), if that section is to be construed to require that 80 percent of the stock of the corporation acquired must be acquired pursuant to a plan of reorganization. Since it already owns 68 percent of the stock of that corporation, it obviously could not acquire an additional 80 percent of its stock.

Does this mean that in such a situation it was impossible for American to bring itself within the terms of section 112(g)(1)(B)?

In such a situation, is it not reasonable to construe section 112(g)(1)(B) to require that the acquiring corporation acquire sufficient additional stock in the other corporation to bring its holdings in it up to the 80 percent requirement?

If this is a permissible construction of section 112(g)(1)(B), the only other requirement is that the acquiring corporation had to acquire this additional amount of stock solely for its own voting stock. This American did, concededly.

I feel quite sure from the statement of facts that there never was a "plan of reorganization" until the issuance of American's prospectus on April 21, 1952. It was then that the plan of reorganization was born. All that went before, it seems to me, should be disregarded in the consideration of this case, except for the purpose of adding to the stock acquired after the formation of the plan of reorganization the stock previously acquired solely for its own voting stock. Therefore, we are obliged to construe section 112(g)(1)(B) as I have indicated above, or be compelled to say that a corporation, already owning 68 percent of the stock of another, cannot possibly qualify under section 112(g)(1)(B).

Can it be that in such case we must inquire how it had

acquired the 68 percent, whether solely for its own stock, or partly for cash, and then hold that it comes within section 112(g)(1)(B), if the 68 percent was acquired solely for its own stock, but not, if a part was acquired for cash? This would seem to me illogical, where the 68 percent had not been acquired pursuant to "a plan of reorganization." What preceded the adoption of the plan of reorganization seems to me to be immaterial, except for the purpose of inquiring whether both before and after the adoption of the plan of reorganization 80 percent of the stock of the transferor corporation had been acquired solely for the voting stock of the transferee. It was what was done after the adoption of the plan that counts in determining whether the stock of the transferor was acquired "only" for the stock of the transferee.

But let us suppose that the statute is concerned, not with the reason behind the acquisition of the stock, but only with the acquisition itself, whatever may have been the reason for it. Then, it seems to me, our inquiry is, was 80 percent of the stock acquired solely for the voting stock of the acquiring corporation? If we find that it was, it seems to me immaterial that it may have acquired an additional percentage of stock for cash, at intervals in the intervening forty years, and not pursuant to a plan of reorganization.

In *Howard* v. *Commissioner, supra*, the transferee corporation offered to acquire 80.19 percent of the stock of the transferor for its voting stock, and the remaining 19.81 percent for cash, and this was done. The Seventh Circuit held that the acquisition for cash of a part of the stock, pursuant to the plan for reorganization, in addition to the 80 percent, took the case out of section 112(g)(1)(B). They apparently thought they were compelled to so hold by the Supreme Court's opinion in *Helvering* v. *Southwest Consolidated Corp., supra.*

In the *Southwest Consolidated Corporation* case there was a single transaction under which all the assets of the transferor corporation were acquired, but the considera-

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tion was partly cash, partly in voting stock and partly in stock warrants. As applied to such facts, the Supreme Court rightly held that the transaction did not meet the requirement that the acquisition be "solely" for the voting stock of the transferee. The consideration was voting stock (most of which was issued to creditors, not stockholders, of the transferor corporation), cash, the assumption of a liability of the transferor corporation (which was held to be the equivalent of cash), and stock warrants (which were held not to be the equivalent of "voting stock"). For more than one reason the Supreme Court held the transaction did not qualify under section 112(g)(1)(B). It was not confronted with a situation where 80 percent of the stock of the transferor corporation had been acquired "solely" for the voting stock of the transferee, and, in addition, in a series of transactions, unrelated to the plan of reorganization, an additional percentage was acquired for cash.

In the case at bar, more than 94 percent of International was acquired "solely" for the voting stock of American, in two transactions. Only 2.69 percent was acquired for cash, in several separate and unrelated transactions. Can it be that the acquisition of this small percentage, at different times, unrelated to the plan of reorganization, so tainted the acquisition of the 94 percent as to completely change its character? I can see no reason why it should. More than the required 80 percent was acquired "solely" for American's voting stock. This seems to me to be all that is required. The acquisition at other times and in unrelated transactions of a small additional amount for cash cannot logically affect the other two transactions where the sole consideration was the voting stock of American.

This case differs from *Howard* v. *Commissioner, supra,* in that in the *Howard* case there was but one transaction involved, in which the offer of the acquiring corporation contemplated the payment of a part of the consideration in cash and a part in the voting stock of the transferee.

While 90+ percent of the stock of the transferor was acquired, it could be said that it was not acquired "solely" for the voting stock of the transferee. In the case at bar in two separate transactions 94 percent of the stock of International was acquired "solely" for the voting stock of American. The additional 2.69 percent acquired for cash were acquired in a series of transactions, over a period of ten years, which had no connection whatever with the plan of reorganization or the other transaction in which stock was acquired "solely" for the stock of American. I can see no reason why these unrelated transactions change the character of the two transactions where 94 percent of the stock of International was acquired "solely" for American's voting stock.

In *Turnbow* v. *Commissioner*, 368 U.S. 337, there was no reorganization because consideration for the transfer of stock by Turnbow was $1,235,625 worth of stock in the transferee, and $3,000,000 in cash. Since there was no reorganization, it was held that sections 112(b)(3), as supplemented by 112(c)(1), were not applicable. These sections are set out in a note below.[2] This is all this case held. It does not seem to me to have any bearing on the question of whether there was a reorganization of American and International.

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[2] Section 112(b)(3) reads:

"Stock for stock on reorganization. No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization."

Section 112(c)(1) reads:

"If an exchange would be within the provisions of subsection (b)(1), (2), (3), or (5), • • • of this section, if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph • • • to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property."

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I think we should hold that where a corporation owning 68 percent of the stock of another decides on a plan of reorganization of the two and pursuant to the plan acquires an additional 26 percent of the stock of the other corporation solely for its own stock, such a corporation is entitled to go back to transactions prior to the adoption of the plan of reorganization and, in order to make up the required 80 percent, pick up additional stock of the other corporation which had been acquired solely for its own stock.

American had acquired more than 94 percent of the stock of International solely for its own stock. I think there was a reorganization under section 112(g)(1)(B).

It would be permissible under the 1954 Code to add to stock last acquired holdings before the last acquisition. Section 368(a)(1)(B) requires that after the acquisition the acquiring corporation be in control of the other "(whether or not such acquiring corporation had control immediately before the acquisition)", and subparagraph (c) defines "control" to mean 80 percent of the combined voting power of all classes of stock and 80 percent of all other classes of stock.

This seems to embrace a case where, before adoption of the plan of reorganization, the acquiring corporation owned more than 50 percent of the stock of the other and, after adoption of the plan, acquired enough more to make up the 80 percent.

The right to do this is not so clear under the 1939 Code, but it is not prohibited and it is the only way a corporation owning 21 percent or more of the stock of another can bring itself within the terms of section 112(g)(1)(B). It is unreasonable to suppose Congress meant to deny to such companies the benefit of this section.

Since I cannot believe that the acquisition of 2.69 percent of International's stock long before the "plan of reorganization" takes the case out of section 112(g)(1)(B), I must respectfully dissent.

Findings of Fact

The court, having considered the facts as stipulated by the parties, and the briefs and argument of counsel, makes findings of fact as follows:

1. George Arents and Lena R. Arents were husband and wife, citizens of the United States, and residents of the City, County and State of New York.

2. The American Machine & Foundry Company is a corporation organized under the laws of the State of New Jersey, and in 1952 was engaged in the manufacture of tobacco machinery including cigarette and cigarmaking machines, bakery equipment, power tools and tool accessories, bicycles, velocipedes and other welded products, and in contract manufacturing under Government contract.

3. International Cigar Machinery Company is a corporation organized under the laws of the State of New Jersey and in 1952 was engaged in leasing to manufacturers of cigars both long filler and short filler cigarmaking machines which had been manufactured by American Machine & Foundry Company and sold to International Cigar Machinery Company.

4. In June 1912 American Machine & Foundry Company acquired, in exchange solely for 11,000 shares of its common stock having a total par value of $1,100,000, from The American Tobacco Company, the following:

a. 65,375 shares of International Cigar Machinery Company capital stock and 16,971 shares of the stock of The Standard Tobacco Stemmer Company at an aggregate price of $769,767.64;

b. Various notes and claims against International Cigar Machinery Company, American Machine & Foundry Company, The Standard Tobacco Stemmer Company and Coffee Stemming Machine Company, for an aggregate price of $295,000; and

c. Cash in the amount of $35,232.36.

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5. The above mentioned 65,375 shares of the capital stock of International Cigar Machinery Company were 65.375 percent of its total issued shares of 100,000.

6. The capital stock of International Cigar Machinery Company was its only stock and was its sole voting stock.

7. The common stock of American Machine & Foundry Company was its only stock having voting rights.

8. In 1927 each share of the capital stock of International Cigar Machinery Company having $100 par value was exchanged for three no par shares, resulting in a three-for-one split and increasing the number of shares acquired in 1912 by American Machine & Foundry Company from 65,375 shares to 196,125 shares.

9. In 1930 the International Cigar Machinery Company shares were split two-for-one, increasing the number of the shares acquired in 1912 by American Machine & Foundry Company to 392,250 shares.

10. From 1929 to and including 1951, the American Machine & Foundry Company, on 10 separate occasions, purchased on the market a total of 16,150 (adjusted for a three-for-one stock split-up in 1927 and a two-for-one stock split-up in 1930) common shares of International Cigar Machinery Company for a total aggregate cost of $554,608.50. These cash purchases, which constitute 2.691⅔ per cent of the total outstanding stock of International Cigar Machinery Company, were made as follows:

Year	*Number of shares*	*Cost*	*Per cent of outstanding stock*
1929	7,750	$365,750.00	1.291⅔%
1931	1,958	66,214.00	.326
1934	3,042	75,348.30	.507
1951	3,400	47,296.20	.567
Totals	16,150	$554,608.50	2.691⅔%

11. In April 1952 American Machine & Foundry Company made an offer to the stockholders of International Cigar Machinery Company to exchange 1⅓ shares of American Machine & Foundry Company common stock for each share of the capital stock of International Cigar Machinery Company.

12. In its Prospectus, dated April 21, 1952, the American Machine & Foundry Company stated that the purposes of this offer were:

a. To enable the American Machine & Foundry Company to acquire all of the shares of International Cigar Machinery Company not then owned by it;

b. To settle a derivative stockholders' action brought by certain International Cigar Machinery Company stockholders against International Cigar Machinery Company and American Machine & Foundry Company;

c. To enable American Machine & Foundry Company to include International Cigar Machinery Company statements in its consolidated financial statements;

d. To increase by $2,000,000 the borrowing power of American Machine & Foundry Company and its subsidiaries under a certain Credit Agreement;

e. To enable American Machine & Foundry Company to include International Cigar Machinery Company in a consolidated federal income tax return, should it so desire.

13. Pursuant to this offer the American Machine & Foundry Company issued, during the calendar year 1952, 235,918⅔ shares of its common stock in exchange for 176,939 shares of the capital stock of International Cigar Machinery Company.

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14. Both the 1912 and 1952 exchanges were made solely for the voting stock of American Machine & Foundry Company and in these exchanges it acquired not less than 94.864 percent of the voting stock of International Cigar Machinery Company.

15. In 1952 George Arents was the owner of 18,000 shares of the capital stock of International Cigar Machinery Company and he accepted the offer and received in exchange for these shares 24,000 shares of the common stock of American Machine & Foundry Company.

16. In 1952 Lena R. Arents was the owner of 100 shares of the capital stock of International Cigar Machinery Company and she accepted the offer and received in exchange for these shares 133⅓ shares of the common stock of American Machine & Foundry Company.

17. George Arents and Lena R. Arents duly filed a joint Federal income tax return for the calendar year 1952.

18. In their joint Federal income tax return for the calendar year 1952, George Arents reported a capital gain of $283,164.65 and Lena R. Arents reported a capital gain of $766.67 resulting from the aforesaid exchanges.

19. Lena R. Arents died on March 11, 1954, leaving a last will and testament which was duly admitted to probate on March 25, 1954, by the Surrogate's Court of the County of New York which on the same date issued letters testamentary to George Arents and United States Trust Company of New York.

20. On May 19, 1954, George Arents individually and George Arents and United States Trust Company of New York as executors of the last will and testament of Lena R. Arents, filed with the District Director of Internal Revenue, Upper Manhattan District, New York, a claim

for the refund of $48,268.34 alleged to have been erroneously paid by them on the capital gains reported as resulting from said exchanges made in 1952.

21. On July 14, 1958, the District Director, Manhattan District, mailed by registered mail to George Arents a notice that, in accordance with the provisions of section 6532(a)(1) of the Internal Revenue Code of 1954, the said claim had been disallowed in full.

22. George Arents died on December 13, 1960, leaving a last will and testament which was duly admitted to probate on December 21, 1960, by the Surrogate's Court of the County of New York which on the same date issued letters testamentary to Clinton S. Lutkins, Sidney W. Davidson and United States Trust Company of New York.

23. The only issue to be determined in this proceeding on the basis of the facts as hereinabove stated is whether the exchange of capital stock of International Cigar Machinery Company for common stock of American Machine & Foundry Company was an exchange of stock for stock on reorganization within the provisions of section 112(b)(3) of the Internal Revenue Code of 1939, resulting in no recognized gain or loss.

24. If the court determines that the plaintiffs are entitled to recover, the parties may stipulate or otherwise agree upon a computation of the recovery under Rule 38(c).

Conclusion of Law

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that the plaintiffs are not entitled to recover and the petition is dismissed.

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APPENDIX B

Statutes Involved

Internal Revenue Code of 1939 as in effect in 1952 (Title 26 U.S.C., 1952 ed.):

§112 *Recognition of gain or loss—*

(a) *General Rule.* Upon the sale or exchange of property the entire amount of gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind*—(1) • • •

(2) • • •

(3) *Stock for Stock on Reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

• • • •

(g) *Definition of Reorganization.*—As used in this section (other than subsection (b)(10) and subsection (l)) and in section 113 (other than subsection (a)(22))—

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, or (C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all the properties of another corporation, but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a

liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded, or (D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (E) a recapitalization, or (F) a mere change in identity, form, or place of organization, however, effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another.

Regulations Involved

The Regulations involved are the following sections from Treasury Regulations 118, promulgated under the Internal Revenue Code of 1939 as in effect in 1952:

Sec. 39.112(a)-1 *Sales or exchanges.* (A) • • •

• • • •

(E) To constitute an exchange within the meaning of section 112(b)(1) to (5), inclusive, section 112(b) (10), and section 112(l), the transaction must be a reciprocal transfer of property, as distinguished from a transfer of property for a money consideration only.

• • • •

Sec. 39.112(g)-1 *Purpose and scope of exception of reorganization exchanges.* (a) *Reorganizations.* As used in the regulations under section 112(g), the terms "reorganization" and "party to a reorganization" mean only a reorganization or a party to a reorganization as defined in such section. With respect to section 112(b)(10) reorganizations, see Sec. 39.112(b)(10)-1.

(b) *Purpose.* Under the general rule, upon the exchange of property, gain or loss must be accounted for

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if the new property differs in a material particular, either in kind or in extent, from the old property. The purpose of the reorganization provisions of the Internal Revenue Code is to except from the general rule certain specifically described exchanges incident to such readjustments of corporate structures, made in one of the particular ways specified in the Code, as are required by business exigencies and which effect only a readjustment of continuing interests in property under modified corporate forms. Requisite to a reorganization under the Code are a continuity of the business enterprise under the modified corporate form, and a continuity of interest therein on the part of those persons who were the owners of the enterprise prior to the reorganization. The Code recognizes as a reorganization the change (made in a specified way) from a business enterprise conducted by a single corporation to the same business enterprise conducted by a parent and a subsidiary corporation, but not the creation of a temporary subsidiary as a device for the making of an ordinary dividend. The Code recognizes as a reorganization the amalgamation (occurring in a specified way) of two corporate enterprises under a single corporate structure if there exists among the holders of the stock and securities of either of the old corporations the requisite continuity of interest in the new corporation, but there is not a reorganization if the holders of the stock and securities of the old corporation are merely the holders of short-term notes in the new corporation. In order to exclude transactions not intended to be included, the specifications of the reorganization provisions of the law are precise. Both the terms of the specifications and their underlying assumptions and purposes must be satisfied in order to entitle the taxpayer to the benefit of the exception from the general rule. Accordingly, under the Code, a short-term purchase money note is not a security of a party to a reorganization, an ordinary dividend is to be treated as an ordinary dividend, and a sale is never-

theless to be treated as a sale, even though the mechanics of a reorganization have been set up.

(c) *Scope.* The nonrecognition of gain or loss is prescribed for two specifically described types of exchanges, viz.: The exchange that is provided for in section 112 (b)(3) in which stock or securities in a corporation a party to the reorganization are, in pursuance of a plan of reorganization, exchanged for the stock or securities in a corporation a party to the same reorganization; and the exchange that is provided for in section 112(b)(4) in which a corporation a party to the reorganization exchanges property, in pursuance of a plan of reorganization, for stock or securities in another corporation a party to the same reorganization. Section 112(g) limits the definition of the term "reorganization" to six kinds of transactions and excludes all others. From its context, the term "a party to a reorganization" can only mean a party to a transaction specifically defined as a reorganization by section 112(g). * * * The provisions of the Internal Revenue Code referred to in this paragraph are inapplicable unless there is a plan of reorganization. A plan of reorganization must contemplate the bona fide execution of one of the transactions specifically described as a reorganization in section 112(g) and for the bona fide consummation of each of the requisite acts under which nonrecognition of gain is claimed. Such transaction and such acts must be an ordinary and necessary incident of the conduct of the enterprise and must provide for a continuation of the enterprise.

Sec. 39.112(g)-2. *Definition of Terms.* (a) * * *

(b) * * *

(c) In order to qualify as a "reorganization" under section 112(g)(1)(B), the acquisition by the acquiring corporation of the required amount of the stock of the other corporation must be in exchange solely for all or a part of the voting stock of the acquiring corporation. If,

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for example, Corporation X exchanges nonvoting preferred stock or bonds in addition to all or a part of its voting stock in the acquisition of the required amount of stock of Corporation Y, the transaction is not a "reorganization" under Section 112(g)(1)(B).

* * * *

(f) The term "a party to a reorganization" includes, in addition to a corporation which performs the specific act constituting the reorganization as described and defined in section 112(g)(1), only a corporation specified in section 112(g)(2). * * * Only Corporations H and J are parties to the reorganization if it consists of the acquisition by Corporation H in exchange solely for all or a part of its voting stock of at least 80 percent of the voting stock and at least 80 percent of the total number of shares of all other classes of stock of Corporation J, even though such acquisition by Corporation H is from Corporation K.

(g) The term "plan of reorganization" has reference to a consummated transaction specifically defined as a reorganization under section 112(g)(1). The term is not to be construed as broadening the definition of "reorganization" as set forth in section 112(g)(1), but is to be taken as limiting the non-recognition of gain or loss to such exchanges or distributions as are directly a part of the transaction specifically described as a reorganization in section 112(g)(1). Moreover, the transaction, or series of transactions, embraced in a plan of reorganization must not only come within the specific language of section 112(g)(1), but the readjustments involved in the exchanges or distributions effected in the consummation thereof must be undertaken for reasons germane to the continuance of the business of a corporation a party to the reorganization. Section 112(g)(1) contemplates genuine corporate reorganizations which are designed to effect a readjustment of continuing interests under modified corporate forms.

APPENDIX C

Order Denying Motion for Rehearing

8–57 FLIPPIN MATERIALS COMPANY, a Joint Venture

353–59 ROBERT M. BENJAMIN and FRANKLIN E. PARKER, JR., Executors

Cong. 3–60 WILLIAM E. STONE

279–60 CLINTON S. LUTKINS, ET AL.

300–60 JOHN BOYLE

20–62 FRANK M. DEFINO

v. THE UNITED STATES

ORDER

These cases come before the court on motions for rehearing, reconsideration, amendment of judgment, new trial and to vacate summary judgment under Rules 53 and 54 of the Rules of this Court, and a motion to take oral depositions. Upon consideration thereof,

IT IS ORDERED this fifth day of April, 1963, that said motions be and the same are denied as follows:

8–57 Flippin Materials Company, a Joint Venture. Plaintiff's motion.

353–59 Robert M. Benjamin and Franklin E. Parker, Jr., Executors. Plaintiffs' motion.

Cong. 3–60 William E. Stone. Plaintiff's motion.

279–60 Clinton S. Lutkins, et al. Plaintiffs' motion. Judge Whitaker would grant plaintiffs' motion for rehearing for reasons set forth in his dissenting opinion of February 6, 1963.

300–60 John Boyle. Defendant's motion.

20–62 Frank M. DeFino. Plaintiff's motions. Judge Davis took no part in the consideration and decision of this motion.

By the Court,

/s/ Marvin Jones
Marvin Jones,
Chief Judge.

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In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 249

CLINTON S. LUTKINS, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinions, findings of fact and conclusions of law of the Court of Claims (Pet. App. A, 1-20) are reported at 312 F. 2d 803.

JURISDICTION

The judgment of the Court of Claims was entered on February 6, 1963 (Pet. App. A, 1, 20), and a timely motion for rehearing was denied on April 5, 1963 (Pet. App. C, 1-2). The petition for a writ of certiorari was filed on July 1, 1963. The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

QUESTION PRESENTED

Section 112(g)(1)(B) of the Internal Revenue Code of 1939 defined a tax free reorganization to include the acquisition by one corporation, in exchange solely for its voting stock, of at least 80 percent of the stock of another corporation. The question presented is whether the acquisition by one corporation of 29.489 percent of the total stock of another in exchange for voting stock, qualifies as a tax free reorganization where, because of the acquiring company's existing holdings of such stock, acquired in part for cash, the acquisition results in its owning more than 80 percent of the stock.

STATUTE INVOLVED

Internal Revenue Code of 1939:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

* * * *

(b) *Exchanges Solely in Kind.*—

* * * *

(3) *Stock for stock on reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

* * * *

(g) [as amended by Sec. 213(b), Revenue Act of 1939, c. 247, 53 Stat. 862 *et seq.*] *Definition of Reorganization.*—As used in this section (other than subsection (b)(10) and sub-

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section (l)) and in section 113 (other than subsection (a)(22))—

> (1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, or (C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all the properties of another corporation, but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded, or (D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (E) a recapitalization, or (F) a mere change in identity, form, or place of organization, however effected.
>
> * * * *

(26 U.S.C. 1952 ed., Sec. 112.)

STATEMENT

The pertinent facts were stipulated by the parties and may be summarized as follows (Pet. App. A, 16-20):

In 1912, American Machine & Foundry Company ("American") exchanged 11,000 shares of its own voting stock for 65,375 shares of the capital stock of International Cigar Machinery Company ("International") plus other consideration not material to this case. The 65,375 shares of International represented 65.375 percent of International's total stock. (Pet. App. A, 16-17.)

At various times over the following 40 years, American made relatively small cash purchases of International stock, so that its ownership at the beginning of 1952 constituted 68.066⅔ percent of International's total stock.[1] In April 1952 American offered to exchange its own voting stock for the capital stock of International at a rate of 1⅓ shares of American for each share of International. Pursuant to this offer it issued 235,918⅔ shares of its own voting stock for 176,939 shares of International's stock, which represented 29.489 percent of International's total issue. (Pet. App. A, 18.)

George and Lena Arents together owned 18,100 shares of International stock which they exchanged in accordance with the terms of the offer for 24,133⅓ shares of American voting stock. They reported a capital gain of $283,931.32 on their 1952 joint income tax return. In 1954 they filed a claim for the refund of taxes alleged to have been erroneously paid on the gains realized from the exchange. The claim was disallowed in full. (Pet. App. A, 19-20.)

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[1] As a result of stock splits in 1927 and 1930 the number of shares held by American in 1952 was 408,400.

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A suit for refund, in which the taxpayers were succeeded by their executors, was duly brought in the Court of Claims. The court, with one judge dissenting, held that the 1952 exchange of American stock for International was not pursuant to a plan of reorganization within the meaning of § 112(g)(1)(B) of the Internal Revenue Code, and that any gain resulting therefrom was taxable. (Pet. App. A, 1-8, 20.)

ARGUMENT

1. The taxpayers' gain from the exchange of their International stock for American stock was nontaxable under § 112(b)(3) and (c)(1) only if the exchange was pursuant to a "reorganization" as defined in § 112(g)(1). See *Turnbow* v. *Commissioner*, 368 U.S. 337. Section 112(g)(1)(B), the only definition invoked by petitioners, defines as a reorganization—

> the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the * * * stock of another corporation * * *.

Standing alone, the 1952 transaction—by which American acquired less than 30% of the stock of International—obviously could not qualify as a reorganization since it was not an "acquisition * * * of at least 80 per centum" of International's stock. To establish an acquisition of the required amount of stock it would be necessary to combine the 1952 acquisition with American's prior acquisitions beginning in 1912. The Court of Claims assumed

arguendo that the several acquisitions could be combined to meet the definition but held that even so they failed to qualify as a "B" reorganization. Since in the course of acquiring the required 80% of International's stock American had acquired 2.691% of the stock for cash (Pet. App. A, 17), the acquisition was not, the court held, "in exchange solely * * * for voting stock."

The court's holding that the payment of cash for a part of the stock prevented a reorganization even though only voting stock was given for more than 80% of the stock is fully consistent with the language of the statute and is supported by *Howard* v. *Commissioner*, 238 F. 2d 943 (C.A. 7),[2] and *Commissioner* v. *Air Reduction Co.*, 130 F. 2d 145 (C.A. 2). See also *Helvering* v. *Southwest Consolidated Corp.*, 315 U.S. 194. There is no conflicting decision and no other reason for review of that holding by this Court.

Moreover, the premise of petitioners' argument that the 1952 acquisition could be combined with the prior acquisitions for purposes of meeting the statutory definition, although accepted *arguendo* by the Court of Claims, seems plainly contrary to the statu-

[2] Our reference is to the first holding of the *Howard* case—*i.e.*, the holding that the transaction there involved did not qualify as a "B" reorganization because cash had been given in exchange for a small part of the stock. The second holding—that the "boot" provision, § 112(c)(1), made the taxpayers' gain nontaxable notwithstanding the failure to qualify as a reorganization—was overruled by *Turnbow* v. *Commissioner*, 368 U.S. 337. Since the first holding of *Howard* supports the decision below and the second was overruled, we are at a loss to understand petitioners' assertion of a conflict with that case (Pet. 6-7).

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tory language. Section 112(b)(3) provides for non-recognition of the taxpayers' gain only if their exchange was "in pursuance of the plan of reorganization." Since a "B" reorganization requires the "acquisition" of "at least 80 per centum" of the acquired corporation's stock, it seems evident that a "plan of reorganization" must contemplate the acquisition of at least that amount of stock. Thus, if two or more partial acquisitions of stock, separated in time, are to qualify as a reorganization, they must at the very least have been made pursuant to a single "plan." Here there is of course no claim that the 1912 exchange and the 1952 exchange were parts of a single "plan" for the acquisition of the required 80% of International's stock. They cannot therefore be combined to meet the 80% requirement.[3]

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[3] See also 3 Mertens, *Law of Federal Income Taxation* (Rev.), Sec. 20.89, which states:

> The 1939 Code described the instant type of reorganization * * * as the *acquisition* by one corporation "of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock" of another corporation. Under the 1939 Code, therefore, there was a serious question whether the statutory definition could be satisfied if the acquired stock was in a quantity less than such 80% interest. Thus, the acquiring corporation may already have acquired 10% of the stock of the acquired corporation in exchange solely for its own voting stock. Was the *acquisition* by such corporation, in a subsequent separate transaction, of an additional 75% an acquisition of *at least 80%* of the voting stock *and at least 80%* of the total number of shares of all other classes of stock of another corporation? Although there was room for a difference of opinion, it seemed reasonably clear that such a transaction was not the *acquisition* of an 80% interest as required by the statute. * * *

2. In any event, because of the changed definition of a "B" reorganization in the 1954 Code, the basic question presented by this case is confined to the 1939 Code and is unlikely to recur.

The Internal Revenue Code of 1954 amended the corporate reorganization provisions so that § 368 (a) (1) (B) now includes within the definition of a "B" reorganization *any* exchange solely for voting stock of the acquiring corporation which results in ownership of more than 80 percent of the total stock of the acquired corporation, no matter how much ownership the acquiring corporation held before the exchange and irrespective of the consideration it gave to acquire such ownership. Congress recognized that "there is doubt as to whether the existing statute [the 1939 Code] permits such an acquisition tax free when the acquiring corporation already owns some of the voting stock of the other corporation," and it enacted the amendment to remove the doubt. S. Rep. No. 1622, 83rd Cong., 2d Sess., 273 (1954) (which also suggests a hypothetical example similar to the facts of the present case). Thus it appears that the 1954 law would clearly render nontaxable an exchange of the sort here involved.[4] Consequently the question

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[4] See Bittker, *Federal Income Taxation of Corporations and Shareholders* (student ed. 1959) 364-365:

> Section 368(a)(1)(B) [of the Internal Revenue Code of 1954] does not require that control of the acquired corporation be obtained in the reorganization itself. Evidently the acquisition of stock in any quantity will suffice, so long as the acquiring corporation has the requisite "control," as defined by § 368(c), immediately after the exchange. In this respect, § 368(a)(1)(B)

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presented by this case is a dead issue which does not require resolution by this Court.

CONCLUSION

For the foregoing reasons the petition for a writ of certiorari should be denied.

Respectfully submitted,

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AUGUST, 1963

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changes pre-1954 law, under which it seemed to be necessary to acquire 80 percent of the acquired corporation's stock in the reorganization itself, so that a corporation that had purchased over 20 percent of another corporation's stock in the past could not use a Type B reorganization to increase its ownership. * * * By virtue of the 1954 change in the phraseology of § 368(a) (1) (B), the acquiring corporation need not obtain "control" in one fell swoop; a "creeping acquisition" of stock (*e.g.*, 10 percent of the stock of a corporation of which the acquiring corporation already owns 75 percent) will qualify, as well as an increase in ownership by a corporation that already has "control."

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

No. 249

CLINTON S. LUTKINS, SIDNEY W. DAVIDSON and UNITED STATES TRUST COMPANY OF NEW YORK, as executors of the last will and testament of George Arents, deceased, and United States Trust Company of New York, as executor of the last will and testament of Lena R. Arents, deceased,

Petitioners,

—against—

UNITED STATES OF AMERICA,

Respondent.

REPLY BRIEF FOR PETITIONERS

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UNITED STATES OF AMERICA,

Respondent.

REPLY BRIEF FOR PETITIONERS

POINT I

The Government, in its Brief in Opposition, frames the "Question Presented" in a manner which tends to mislead and which conceals facts which show compliance with the statute.

It reads in part:

"The question presented is whether the acquisition by one corporation of 29.489 percent of the total stock of another in exchange for voting stock, qualifies as a tax free reorganization where, because of the acquiring company's existing hold-

> ings of such stock, acquired in part for cash, the acquisition results in its owning more than 80 percent of the stock."

This language does not reveal that in our case over 80 percent of the stock was acquired solely in exchange for voting stock of the acquiring corporation, as required by the statute, and as found by the Court of Claims, and it carries the implication that the cash purchases must be added in order to complete the acquisition of the 80 percent. The Government seems to assume that the statute provided that all acquisitions of stock be made solely in exchange for the voting stock of the acquiring corporation. The legislative history of section 112(g)(1)(B) shows that Congress believed that the acquisition of 80 percent (rather than a bare majority, as in the prior law) of the voting stock of the corporation being acquired, solely in exchange for the voting stock of the acquiring corporation (to insure continuity of interest and control) was sufficiently similar to a statutory merger or consolidation to be entitled to the same tax treatment.

The question presented is therefore, precisely as stated in the petition, namely, whether a reorganization is prevented by the purchase of additional voting stock for cash.

In the first part of its argument the Government states that since, in the course of acquiring 80 percent of International's stock American acquired 2.691% of the stock for cash the acquisition was not "in exchange solely * * * for voting stock". This is an attempt to convince this Court, as the Court of Claims apparently concluded, that the cash *purchases* were

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part of the *exchanges*, despite the fact that they were made in years other than the years of the exchanges. This ignores the provisions of the Government's own regulations, quoted in Appendix B, p. 2 of the petition, which distinguish an exchange as "a reciprocal transfer of property" from a cash purchase, "a transfer of property for a money consideration only". The *exchanges* were solely for stock and for more than 80 percent of the stock.

POINT II

The Government errs in stating that there is no conflict between the decision of the Court of Claims in the instant case and the decision of the Circuit Court of Appeals for the Seventh Circuit in *Howard* v. *Commissioner*.

The Government persists in its erroneous contention which it made before the Court below to the effect that the *Howard* case was overruled by this Court in *Turnbow* v. *Commissioner*, 368 U.S. 337.

The *Howard* case was not overruled as it was not before this Court and the facts in that case are easily distinguishable from those in the *Turnbow* case. The facts in the *Turnbow* case showed clearly that the requirements of the definition of "reorganization" in the Internal Revenue Code of 1939 were not met as only 30 percent of the stock was acquired solely for voting stock of the acquiring corporation, whereas in the *Howard* case 80.19 percent was acquired solely for voting stock, or an amount in excess of the percentage required by the statute. In the *Howard* case, therefore, in the words of Mr. Justice Whittaker "some

part, at least, of the property exchanged *actually* meets the particular description contained in the applicable section or subsection of the Code."

There is nothing in the *Turnbow* decision to indicate that the *Howard* decision would have been reversed if it had been considered by this Court and in fact the *Turnbow* opinion contains a cautionary statement against giving it too wide application. This is the only possible interpretation of the statement, 368 U.S. at 344: "That holding determines this case and *is all we decide.*" (Emphasis supplied.)

POINT III

The question presented is not a "dead issue."

In item (2) of its argument the Government contends that the "question presented by this case is a dead issue which does not require resolution by this Court" apparently on the ground that under the 1954 law "an exchange of the sort here involved" would be nontaxable. There is no statement, however, as to whether other taxpayers have open cases, still undecided, involving similar facts under the 1939 law, and to whom the issue would in no event be a "dead issue".

The Government cites the statement by the Senate Committee on Finance, (S. Rep. No. 1622, 83rd Cong., 2d Sess., 273) dealing with the bill which became the Internal Revenue Code of 1954, to the effect that "there is doubt as to whether the existing statute permits such an acquisition tax free when the acquiring corporation already owns some of the voting stock of

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the other corporation". Some writers have thought that the Senate exaggerated the doubt in this area.[1]

The question presented by this case and decided by the Court of Claims, erroneously it is believed, is by no means "a dead issue" but is one which will arise also under the Internal Revenue Code of 1954, and will persist until it has been decided authoritatively by this Court. Each Code involves, in the definition of a Type B reorganization, an "acquisition" of stock of one corporation "in exchange solely for all or a part of" the voting stock of another corporation, the acquiring corporation. In the instant case the Court of Claims found as a fact that the requisite percentage of shares had been acquired in exchange solely for voting stock of the acquiring corporation but in spite of this the Court held that the "acquisition" did not result in a "reorganization". The Court of Claims aggregated the cash "purchases" made in other years with the "exchanges solely for voting stock" and held that the acquisition was not "solely for voting stock".

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[1] See Merritt "Tax-Free Acquisition of Corporate Business", New York University Thirteenth Annual Institute on Federal Taxation, 1955, p. 722:

> The Senate Report overstates somewhat the area of doubt existing under the 1939 Code. The "tacking on" problem was probably not serious if the taxpayer could prove that all the stock acquisitions, including those previously made, were made in exchange solely for voting stock of the acquiring corporation.

In this statement Mr. Merritt himself "overstates" the requirements of the 1939 Code as he seems to be under the impression that the statute requires that *all* the stock acquired be acquired in exchange solely for voting stock of the acquiring corporation. The Court of Claims may have also been under the same impression. All that the 1939 statute required was that at least 80 percent be acquired in exchange solely for voting stock and there is no provision as to time of acquisition or the number of exchanges required for "the acquisition".

What is to prevent, therefore, the Court of Claims, or any other Federal Court, in a case arising under the Internal Revenue Code of 1954, from aggregating cash purchases of stock in earlier years with acquisitions in exchange solely for voting stock in the taxable year and deciding that the provisions of section 368(a)(1)(B) of the Internal Revenue Code were not met? It is the fear of such a result as reflected in the statement by Maremont Corporation quoted on p. 10 of the Petition, that indicates the continuing uncertainty in this area of the tax law and which makes clarification by this Court so important and desirable.

CONCLUSION

The petition for a writ of certiorari should be granted.

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